No. 82-1766

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION, *et al.*,
*Petitioners,*

v.

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM, *et al.*,
*Respondents.*

**On Writ of Certiorari to the United States
Court of Appeals for the District of Columbia Circuit**

## BRIEF FOR GOLDMAN, SACHS & CO. AS AMICUS CURIAE IN SUPPORT OF PETITIONER SECURITIES INDUSTRY ASSOCIATION

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## QUESTION PRESENTED FOR REVIEW

Did the court of appeals err in upholding the legal determination of the Board of Governors of the Federal Reserve System (the "Board") that a commercial bank may market third-party commercial paper to the institutional investing public without violating the Glass-Steagall Act?

## TABLE OF CONTENTS

## Table of Contents Continued

## TABLE OF AUTHORITIES

**Table of Authorities Continued**

**Table of Authorities Continued**

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Goldman, Sachs & Co. ("Goldman Sachs") respectfully submits this brief as *amicus curiae* in support of petitioner Securities Industry Association (the "SIA").

### INTEREST OF AMICUS CURIAE

Goldman, Sachs & Co. is a partnership engaged in the securities and investment banking business, part of which consists of acting as a dealer in commercial paper.[1] The firm, together with its predecessors, has been continuously and actively en-

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[1] Since August 1983, Goldman Sachs has conducted its commercial paper business through a wholly-owned subsidiary corporation, Goldman Sachs Money Markets Inc. References to Goldman Sachs in this Brief include Goldman Sachs Money Markets Inc.

gaged in the marketing of commercial paper since 1869. The firm has extensive experience in the field of commercial paper placement. Goldman Sachs is, and for many years has been, the largest dealer in the United States in terms of the dollar volume of the outstanding commercial paper of its issuing clients.

Pursuant to leave granted by the courts below, Goldman Sachs filed briefs as *amicus curiae* in support of SIA. Goldman Sachs urges that the marketing of third-party commercial paper notes by Bankers Trust Company ("Bankers Trust" or the "Bank") to unaffiliated investors is an activity not engaged in by commercial banks in this country at least since the adoption of the Glass-Steagall Act in 1933, and constitutes a violation of that statute.[2] Goldman Sachs also urges that the Federal Reserve Board (the "Board") erred in its legal determination that Glass-Steagall has no application to the Bank's marketing activity on the theory that commercial paper does not constitute "notes" within the meaning of Glass-Steagall Section 21, 12 U.S.C. § 378. In pertinent part, that statute forbids deposit-taking institutions, such as Bankers Trust, to engage in the "business of issuing, underwriting, selling, or distributing . . . notes, or other securites."

## SUMMARY OF ARGUMENT

Bankers Trust's marketing of commercial paper of third-party issuers to unaffiliated non-bank investors launches the commercial banking industry into uncharted and novel activities. Those activities expose the Bank to hazards that Glass-

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[2] Although this Brief makes numerous references to Bankers Trust in the course of developing its argument, Goldman Sachs does not mean to suggest that the Bank is less likely than other commercial banks to avoid the hazards described herein. The Federal Reserve Board's determination regarding Bankers Trust presumably applies to all commercial banks proposing to undertake similar activities, and Goldman Sachs argues that the Glass-Steagall Act was intended to insulate all commercial banks from such hazards.

Steagall was intended to prevent—*first*, by introducing a "salesman's stake" in the marketing of third-party commercial paper that threatens to disturb the Bank's disinterested analysis of the creditworthiness of commercial paper issuers; and *second*, as happened to Goldman Sachs in the Penn Central collapse, by exposing the Bank to legal claims from purchasers of the paper if the issuer defaults.

The Bank's conduct in regard to commercial paper constitutes a radical departure from traditional activities of commercial banks, which until now have *purchased* commercial paper as *lenders* to third-party issuers. Bankers Trust's new marketing role violates Glass-Steagall, because it amounts to the "underwriting, selling, or distributing [of] . . . notes, or other securities" in violation of Glass-Steagall Section 21.

## ARGUMENT

### I. THE MARKETING ACTIVITY OF BANKERS TRUST IS CONDUCT THAT IS FORBIDDEN BY GLASS-STEAGALL SECTION 21 AND THAT GIVES RISE TO HAZARDS CONGRESS MEANT TO FORESTALL

The court of appeals adopted the Board's "functional anaylsis" of the commercial paper at issue. *E.g., A. G. Becker Inc.* v. *Board of Governors of the Federal Reserve System*, 693 F.2d 136, 147 (D.C. Cir. 1982) (J.A. 241).[3] The court might more properly have described the analysis as "non-functional." For the Board's approach entails consideration of commercial paper in the abstract, without regard to the nature of Bankers Trust's activity in marketing that paper to unaffiliated customers. *See id.* at 148 n.75 (J.A. 243). By failing to take as the centerpiece of analysis that Bankers Trust is *marketing* third-party paper, both the Board and the court of appeals overlooked key purposes of Glass-Steagall, and particularly its Section 21—notably, to shield the Bank's disinterested advice from the untoward influence that inevitably follows from its

[3] "J.A." refers to the Joint Appendix filed in this Court.

looking to the salesman's commission rather than the borrower's interest payments as the source of its profit on the transaction.

The objectives of the Glass-Steagall Act are well known. Following the banking crisis that beset the nation with the collapse of the securities markets in 1929, Congress determined to remove the commercial banking industry from virtually all aspects of the marketing of corporate instruments and to restrict the commercial banking system to its traditional functions—accepting deposits and making loans.[4] That basic policy decision was sound and should be enforced by the courts.

### A. Glass-Steagall Bars Bankers Trust From "Underwriting, Selling, or Distributing" Commercial Paper

Glass-Steagall Section 21, 12 U.S.C. § 378, is a key provision of the statutory scheme, and is controlling here. In pertinent part, Section 21(a)(1) makes it unlawful for any institution engaged in the business of receiving demand deposits also to

> "*engage . . . in the business of* issuing, *underwriting, selling, or distributing*, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, *notes*, or other securities" (emphasis supplied).

The prohibition of Glass-Steagall Section 21 is plain and sweeping. The statute forbids any entity providing commercial banking services to market a wide variety of corporate instruments, including "notes." Violation is a criminal offense. As the district court correctly put it: "The statute draws broad lines, leaving no room for administrative amendment." *A. G. Becker Inc.* v. *Board of Governors of the Federal Reserve System*, 519 F. Supp. 602, 614 (D.D.C. 1981) (J.A. 214).

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[4] *See generally Investment Company Institute* v. *Camp*, 401 U.S. 617, 629 (1971) (Glass-Steagall a "drastic step" to keep commercial banks "from going into the investment banking business"); *Baker, Watts & Co.* v. *Saxon*, 261 F. Supp. 247, 249-50 (D.D.C. 1966) (Holtzoff, J.), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 129 U.S. App. D.C. 173, 392 F.2d 497 (D.C. Cir. 1968).

Under Glass-Steagall Section 21, Bankers Trust's handling of third-party commercial paper is unlawful if the activity constitutes "engag[ing] in the business" of any one or more of "underwriting, selling, or distributing," provided only that the paper marketed by the Bank is deemed "notes, or other securities" within the statute. This is the case without regard to whether the Bank's activity is "at wholesale or retail, or through syndicate participation."

Bankers Trust's activity plainly amounts to at least three of the four forbidden kinds of activity. Consequently, the activity is prohibited to Bankers Trust under Section 21 if (as we shall demonstrate in Part II of this Brief) the commercial paper constitutes "notes" or "other securities."

### 1. "Selling"

Bankers Trust undeniably is engaged in "selling" the commercial notes of third-party issuers. The Board conceded the point in the court of appeals. Brief for Appellant at 46. Moreover, the Bank's general counsel so advised the Board:

> "The activity consists of acting as financial advisor to and agent for an issuer of commercial paper. BTCo, acting as financial adviser to the issuer, checks the market for the issuer. BTCo then advises the issuer how much, at what rate and for what maturity it should sell commercial paper. *Then BTCo, acting as the issuer's agent, sells such commercial paper to those who are interested*" (J.A. 33) (emphasis supplied).

### 2. "Distributing"

Bankers Trust also has acknowledged that its commercial paper activities entail distribution. As the Bank states in its soliciting materials, it seeks "to expand sales *distribution,*" so as to put the commercial paper issuer "in contact with more segments of the market . . . [and] to increase demand for your commercial paper" (J.A. 40; *see* J.A. 43) (emphasis supplied).

### 3. "Underwriting"

The Bank also is engaged in "underwriting." Before the Board, Bankers Trust nominally disclaimed any responsibility to the commercial paper issuer to place the paper sought to be marketed through its facilities. But the Bank acknowledged that if all of the paper brought to market could not be sold on the date of proposed placement, the Bank might well advance an overnight loan to the issuer "using the unsold paper as collateral" (J.A. 37), or, putting it differently, "without prior commitment, [the Bank might] lend short term funds [to the issuer] at or near the commercial paper rate . . ., taking back notes . . . as evidence of indebtedness" (J.A. 54).

The Bank also acknowledged that on behalf of its parent holding company, the Bank was making purchases "in the secondary market [of commercial paper] of issuers for which it acts as agent and financial advisor" (J.A. 55). Presumably this referred to "buy-back" transactions effected by the Bank where the original purchaser of the paper had an unexpected need for cash.

While the SIA and A. G. Becker petitions were pending before the Board, a member of the Board's legal staff advised the Governors that there was reason to question the Bank's assertion that its activities fell outside the strictures of Glass-Steagall:

> "That's what they say but there are two modifying conditions. First of all, they told us that the parent holding company does purchase paper that the bank is selling for the holding companies *[sic]* own account. Now we haven't been able to connect that up to show that it's like an underwriting. The holding company may be holding it as a permanent investment *but they said it's possible that the holding company may have sold the paper out of the holding company's portfolio which makes it look sort of like an underwriting*. The other thing that qualifies it is *Bankers Trust will make a loan at the commercial paper rate for a portion of the unsold proceeds of the paper that the bank is trying to sell*" (J.A. 111) (emphasis supplied).

In other words, it appeared that the Bank was undertaking to its commercial paper issuers that it would take up unsold paper itself, and that the Bank might temporarily "park" paper with its holding company parent for subsequent resale if necessary to assure the success of the offering. The Board subsequently confirmed this understanding of the Bank's activities (J.A. 123), which we submit amount to "underwriting" activities in the placement of paper.

In sum, Bankers Trust actively seeks out purchasers for the commercial paper offered by the third-party issuer. The Bank protects the issuer in the event the paper cannot be fully placed on the day of offer (J.A. 37, 54). And the Bank apparently is "parking" paper for subsequent resale with its holding company parent (J.A. 111).

The tentative phrasing of Bankers Trust's representations concerning the actions it might take if it is unable to sell out an issuer's commercial paper should be viewed with skepticism. Bankers Trust is competing with other firms, such as Goldman Sachs, that market commercial paper. Competitive pressures will lead Bankers Trust to purchase unsold commercial paper in situations where investment banking firms would do so.

Such activities qualify the Bank's activities as an underwriting. In effect, the Bank offers the issuers reasonable assurances, either tacit or explicit, that either the Bank itself or its holding company parent will meet the funding needs of the would-be borrower. In such circumstances, the status of the transaction as an underwriting, and of the bank as an underwriter, cannot seriously be disputed.[5]

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[5] As one district court concluded in a case involving Goldman Sachs: "There can be no serious question that in buying virtually all of the paper issued by . . . [the issuer], distributing it to investors and taking the unsold portions into its inventory, [Goldman Sachs] functioned as an underwriter both as that term is defined in the Securities Act [of 1933] and as commonly understood in the American financial community." *University Hill Foundation* v. *Goldman, Sachs & Co.*, 422 F. Supp. 879, 900 (S.D.N.Y. 1976) (footnotes omitted).

An independent basis for treating a commercial paper dealer as an "underwriter" under Glass-Steagall Section 21 arises from the reliance that commercial paper investors place — at least to a significant degree — on the dealer's reputation in making their investment decisions. In a case in which holders of defaulted paper sued a dealer, Judge Stevens (as he then was) said:

> "The relationship between the underwriter and its customers implicitly involves a favorable recommendation of the issued security. Because the public relies on the integrity, independence and expertise of the underwriter, the underwriter's participation significantly enhances the marketability of the security." *Sanders* v. *John Nuveen & Co.*, 524 F.2d 1064, 1070 (7th Cir. 1975) (footnotes omitted), *vacated and remanded on other grounds*, 425 U.S. 929 (1976).

The degree of sponsorship of an issuer that is implicit in a commercial paper dealer's marketing role confirms that a dealer should be deemed an "underwriter" for purposes of Glass-Steagall.[6]

**B. Bankers Trust's Marketing Of Third-Party Commercial Paper Poses Hazards Sought To Be Eliminated By Glass-Steagall**

Bankers Trust's marketing of third-party commercial paper gives rise to hazards of the kind that Congress sought to remove from the commercial banking sector when it enacted Glass-Steagall—hazards not adverted to in the court of appeals' opinion, but nonetheless real. Because the briefs of petitioners SIA and A. G. Becker will deal extensively with this issue, Goldman Sachs will limit this aspect of its discussion to two concerns that are particularly pertinent to its experience as a commercial paper dealer.

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[6] Goldman Sachs does not necessarily agree with the scope of investigatory duties imposed by the Seventh Circuit in *Sanders* upon the commercial paper dealer for purposes of securities act liabilities. *Compare University Hill Foundation, supra*, 422 F. Supp. at 899-901.

### 1. Bankers Trust Necessarily Has a "Salesman's Stake" in the Transaction

In *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971) *("ICI I")*, this Court concluded that Congress had

> "acted to keep commercial banks out of the investment banking business largely because it believed that the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system." 401 U.S. at 634.

These concerns recently have been echoed by E. G. Corrigan, President of the Federal Reserve Bank of Minneapolis, who has commented that two of the essential functions of banks depend upon the avoidance of such hazards. Corrigan, *What is a Bank Under the Holding Company Act?*, Am. Banker, March 31, 1983, at 11. *First*, the role of banks as issuers of "transaction accounts" gives rise to concerns about strains on bank liquidity and sudden drains on commercial bank demand deposits—dangers that can be avoided only by preserving public confidence in banks' capacity to meet their deposit obligations. "The evidence is overwhelming . . . that most 'problem' bank situations in recent years involved concerns growing out of losses or perceived losses associated with lending, securities activities, foreign exchange activities and/or poor management." *Id.* at 23.

*Second*, commercial banks occupy a critical role as "the primary source of liquidity for all other classes and sizes of institutions, both financial and nonfinancial." *Id.* at 23. The ability of a bank to fulfill this role depends on its ready access to deposit and nondeposit sources of funding. These in turn depend on market judgments concerning, among other things, "the quality and consistency of credit judgments made by banks." *Id.* at 24. Particularly in periods of stress, "banks must be in a position to make rigorous, impartial, and objective credit decisions, because it is precisely in such circumstances that the potential for compromise in the impartiality of the

credit decision making process is greatest and the potential for asset quality deterioration is the largest." *Id.* at 24.

A bank acting as commercial paper dealer subjects itself to the stresses and hazards described above. Bankers Trust, for example, is no longer extending a loan to a borrower on the strength of the issuer's paper; it is promoting the paper to unrelated investors, to induce *them* to take up the paper. The former class of transaction is the traditional lending function of the bank, in which it looks to the interest (or discount) for its return. In the latter class of transaction, the bank bases its return on the commissions associated with its salesman's stake, with a concomitant impact on the bank's disinterested analysis of the creditworthiness of the issuer. The district court stated the point cogently:

> "The problem with the Board's analysis [is that] it ignores the specific conduct of the bank, glossing over whether the bank purchases commercial paper for its own account . . . or purchases for future sale to an outside party or arranges a transaction between purchaser and seller. . . . One factor present in this matter compels the conclusion that the commercial paper at issue here is not a loan, and *that crucial aspect is the role of Bankers Trust in the transactions.*" 519 F. Supp. at 615-16 (J.A. 217) (emphasis supplied) (footnote omitted).

In dealing with a commercial paper issuer, a bank acting as dealer is subject to a continuing tension between (i) protecting the bank's customers who have purchased the issuer's commercial paper, and (ii) protecting the bank's own line of credit facility. Take the case of an issuer that has availed itself of the bank's commercial paper marketing services, has opened a line of credit facility with the bank, and subsequently experiences financial distress. The bank now faces a dilemma. If it refuses to assist the issuer in rolling over its outstandings, or in marketing new paper, it exposes its funds if the issuer draws on its line of credit in order to pay the paper as it matures. If the bank decides to continue to market the paper, it opens itself to the charge that it did so to protect its own position. In either case, the credit judgment may be perfectly appropriate given

the issuer's particular circumstances, but it can hardly be deemed disinterested, impartial, or objective as intended by Congress in Glass-Steagall.

A non-bank commercial paper dealer does not confront such a dilemma. Commercial paper issuers are required in nearly all instances to arrange back-up bank lines of credit equal in amount to 100 percent of the face value of the commercial paper to be marketed. That is, the issuer must arrange for a commercial bank to provide stand-by lending authority sufficient to cover the full amount of the commercial paper when it comes due. The non-bank dealer is not responsible for the bank line of credit. Thus, it can require the issuer to resort to the line of credit solely on the merits of the issuer's creditworthiness.

The Board's "guidelines" regulating commercial bank marketing of commercial paper do not deal with the potential conflict arising from the Bank's dual role as dealer and back-up lender, other than to restrict the selling bank's participation in supporting lines of credit up to the amount of its legal lending limit. 46 Fed. Reg. 29,333-34 (1981). Nor did the court of appeals below consider this potential hazard.

### 2. The Marketer Makes Implied Representations Regarding the Creditworthiness of the Issuer

As a matter of law, Bankers Trust's marketing of third-pary commercial paper carries the Bank's implied representation under Section 12(2) of the 1933 Securities Act, 15 U.S.C. § 77l(2), that in its opinion the issuer is creditworthy, and that that opinion has a reasonable basis—that is, that a reasonable credit investigation has been conducted. For breach of the implied representations, the Bank may be held liable, just like a commercial paper house, in a private action brought by a purchaser of the paper. *E.g.*, *University Hill Foundation* v. *Goldman, Sachs & Co.*, *supra*. That risk of liability places an additional burden on the business of commercial banking that Congress in 1933 determined commercial banks should not bear.

Contrary to the court of appeals' professions of confidence, based on low default rates, short maturities, and large denominations (*see* 693 F.2d at 148-49; J.A. 244-46), it cannot be assumed that the modern commercial paper market is free of risk even to the knowledgeable, sophisticated investor. As Judge Robb noted in dissent below (693 F.2d at 153-54; J.A. 253-55), Goldman Sachs unfortunately had occasion to learn as much in connection with the demise of Penn Central. *See University Hill Foundation*, *supra*, and related cases. The liability of marketers attendant upon the bankruptcy of corporate issuers was one of the burdens that Congress intended in Glass-Steagall to lift from the commercial banking industry.

* * *

The Bank's exposure to risks of conflict of interest and increased potential liability for the financial distress of third-parties cannot be dismissed as speculative or remote possibilities beyond the ken of Congress. To the contrary, the remarks of Senator Bulkley, one of the principal supporters of the Glass-Steagall legislation, demonstrate that such concerns were uppermost in the mind of the enacting Congress:

> "Obviously, the banker who has nothing to sell to his depositors is much better qualified to advise disinterestedly and to regard diligently the safety of depositors than the banker who uses the list of depositors in his savings department to distribute circulars concerning the advantages of this, that, or the other investment on which the bank is to receive an originating profit or an underwriting profit or a distribution profit or a trading profit or any combination of such profits." 75 Cong. Rec. 9912 (1932), *discussed approvingly in ICI I*, *supra*, 401 U.S. at 633.

Congress had before it potential risks of the sort involved here when it enacted Glass-Steagall. It determined that rather than permit the Board to embark on a case-by-case analysis of the risks presented in particular circumstances, Congress would remove commercial banks by legislation from *any* exposure to those risks. That decision was implemented by means of plainly written, straightforward statutory prohibitions.

Congress has not acted to relax these prohibitions, nor is there any reason in policy to relax them. As one highly respected bank regulator has observed:

> "The case for segregating essential banking functions into an identifiable class of institutions is every bit as powerful today as it was in the 1930s. If anything, concerns regarding financial concentration, conflicts of interest, and the fiduciary responsibilities associated with lending depositors' money may be more relevant today than they were 50 years ago." Corrigan, *What Is a Bank Under the Holding Company Act?*, *supra*, at 25.

## II. THE COMMERCIAL PAPER MARKETED BY BANKERS TRUST IS A "NOTE" WITHIN GLASS-STEAGALL SECTION 21

### A. The "Notes" In Section 21 Cannot Properly Be Limited to "Investment Notes"

The term "notes" is not defined in Glass-Steagall—a fact that by itself suggests the word was meant to have its conventional meaning. This Court has admonished that the language of the statute is not to be given a narrow reading. *ICI I*, *supra*, 401 U.S. at 635. The Board forthrightly acknowledged in its statement of legal position issued in this proceeding that "the words in statutes should generally be interpreted in light of their ordinary meaning" (J.A. 131) (footnote omitted). Bankers Trust candidly advised the court of appeals that "commercial paper generally is defined as a kind of note" (Brief for Bankers Trust Company as *Amicus Curiae*, at 8). The district court concluded after careful analysis that the commercial paper marketed by Bankers Trust is a "note." 519 F. Supp. at 612-13 (J.A. 211-12). Even the court of appeals acknowledged in one point of its analysis that

> "the term 'notes' is sometimes used generically to refer to *any* promissory instrument, regardless of maturity or negotiability. In this sense, commercial paper may also be referred to as a promissory 'note.' " 693 F.2d at 143 (J.A. 234) (emphasis in original) (footnote omitted).

Nonetheless, the court of appeals concluded that the "notes" which are the subject of Glass-Steagall Section 21 do not in-

clude all "notes," but only a subspecies called "investment notes." That conclusion was erroneous.

### 1. The Distinction Between "Notes" and "Investment Notes" is Unsupported in the Statute, Its Legislative History, and the Precedents

#### a. The Statutory Language

The text of Glass-Steagall Section 21 does not make the distinction between "notes" and "investment notes" advanced by the court below. The Section refers only—and pointedly—to "notes," as one of several categories of corporate instruments that commercial banks are forbidden to issue, sell, distribute, or underwrite. "Notes" are joined in the statutory prohibition by other forms of corporate instruments—"stocks, bonds, debentures," and "other securities." Like bonds and debentures, but unlike stocks, notes are promises to pay stated amounts at stated times. If, as the court of appeals thought, "notes" in Section 21 are to be known by the company they keep, 693 F.2d at 143 (J.A. 235), that company is mixed indeed. It includes written evidences of both straightforward promises to pay (bonds, debentures) and equity interests that may or may not promise to pay anything (stocks, other securities).

If Section 21 applied only to bonds, debentures, and notes, the court below could not plausibly have reasoned that the term "notes" means only some notes; plainly the term would refer to any promise to pay. But Section 21 applies more broadly. It includes stocks and other securities as well as notes, bonds, and debentures. From this circumstance it hardly follows that the term "notes" must mean something less than it otherwise would.

The court of appeals pointed to the supposedly short-term character of "notes" as contrasted to the long-term character of the other instruments covered by Section 21. *Id.* (J.A. 234). But Section 21 is not limited to "long-term" notes. If Congress had wished to restrict the Section in such a fashion, it knew how to do so. In Section 3(a)(3) of the 1933 Securities Act, passed only three weeks earlier, Congress exempted from the

registration requirement "any note . . . which [among other things] has a maturity at the time of issuance of not exceeding nine months . . . ." 48 Stat. 76. Congress drew no such line when it adopted Glass-Steagall Section 21.[7]

**b. The Legislative History**

The court of appeals found support for its distinction between "investment" and "commercial" notes in the legislative history of Glass-Steagall, 693 F.2d at 144-45 (J.A. 236-37), even as it professed surprise that "Congress nowhere considered the banks' activity in the commercial paper market as contributing to their difficulties." *Id.* at 145 (J.A. 236) (footnote omitted). The paucity of legislative material is not attributable to a congressional design that commercial banks should be left free to handle commercial paper in whatever manner they see fit. It is explained, rather, by the contemporaneous economic reality, recognized elsewhere by the court below, that "almost all commercial paper issued was purchased by commercial banks for their own account," 693 F.2d at 145 n.50 (J.A. 236), and that at the time Glass-Steagall was enacted, banks "purchased the vast bulk of instruments sold through the commercial paper market." *Id.* at 150 n.85 (J.A. 246). In other words, at the time Glass-Steagall was enacted, commercial paper was handled by commercial banks as conventional *lenders*, extending credit for their own account to commercial paper issuers as bank borrowers.

Thus, it is not surprising that what little pertinent legislative material there is uniformly reflects the Congressional intent that commercial banks should remove themselves from the activities of distributing and selling, and should revert to their traditional role as lenders. The Senate report that accompanied the Glass bill criticized the "loose banking policy" that

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[7] The 1933 Securities Act is instructive in another regard. There Congress qualified its definitional sections by the prefatory phrase "unless the context otherwise requires." 15 U.S.C. § 77b. Congress made no such definitional proviso in Glass-Steagall.

had departed from "the making of *loans* on commercial paper." S. Rep. No. 77, 73d Cong., 1st Sess. 4 (1933) (emphasis supplied). Senator Walcott, a floor manager of the Glass bill, expressed concern that corporations had ceased to finance their requirements "by *borrowing at the commercial banks* upon their commercial paper—that is, *upon their notes*." 75 Cong. Rec. 9904 (1932) (emphasis supplied). Significantly, this Senator not only equated "commercial paper" with "notes," but regarded the commercial banks' proper role in the handling of commercial paper to be that of lenders to the issuers, *i.e.*, purchasers of the paper for the banks' own account.

An important indication of contemporaneous legislative intent, overlooked by the court below, may be found in a series of amendments to Glass-Steagall considered by Congress in 1935, two years after the enactment of the statute. One of the proposed amendments would have revised Glass-Steagall Section 16 (now codified as 12 U.S.C. § 24, Paragraph Seventh) to permit national and state member banks to "*underwrite* and *sell* bonds, debentures, and *notes*." H.R. 7617, 74th Cong., 1st Sess. § 308(a), 79 Cong. Rec. 11,927 (1935) (emphasis supplied).[8] The proposed amendment would have imposed comprehensive restrictions on the permitted underwritings and sales activities, and would have subjected those activities to additional limits to be prescribed by the Comptroller of the Currency. Significantly, the proposed amendment would *not* have conferred comparable authority upon banks to underwrite and sell "stocks . . . or other securities"; as to these, the general prohibitions of Sections 16 and 21 would have remained. Despite the limited reach of the proposed amendment, and its elaborate structure of restrictions and regulations, the proposed amendment was stricken in conference. *See* H.R. Rep. No. 1822, 74th Cong., 1st Sess. 53 (1935). Congress thus rejected an amendment that would have permitted precisely

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[8] The proposed amendment is discussed in S. Rep. No. 1007, 74th Cong., 1st Sess. 16 (1935), and quoted in 79 Cong. Rec. 11,927 (1935). The provisions of Section 16 apply to state-chartered institutions such as Bankers Trust by virtue of Section 5(c), Paragraph Fifth, of the Banking Act of 1933, 12 U.S.C. § 335.

the activity—the underwriting and selling of notes—on which Bankers Trust has embarked here.

**c. The Precedents**

The court of appeals pointed to no judicial precedent at all, nor to any pertinent prior Board ruling, to support its limitation of "notes" in Glass-Steagall to "investment notes." A 1973 interpretive ruling of the Board points up the difficulties with the court's reasoning. In 12 C.F.R. § 250.221, the Board disallowed a bank holding company's proposal to market "thrift notes" for financing non-bank operations, in part because of "the abuses that gave rise to the passage" of Glass-Steagall. Although the Board purported to distinguish "commercial paper" on the basis of its larger denomination and restricted sales to knowledgeable purchasers, neither of those distinctions can be found in Glass-Steagall.

**2. The Supposed Distinction Between "Investment Notes" and "Commercial Notes" Does Not Exist in the Real World**

The court of appeals thought that commercial paper "differs sharply" from "investment" notes; the former, it said, are used to raise short-term operating funds, while the latter are employed only for longer-term capital commitments. 693 F.2d at 143 (J.A. 243). This is incorrect. The asserted economic distinction between short-term credit and long-term capital finance was blurred even during the period antedating Glass-Steagall. As described by one authority:

> "The actual uses to which businesses put the advances [represented by notes] were significantly different from those sanctioned by 'classical' theory. *Short-term bank credit was used to a large extent for meeting enduring needs for working capital or for financing the acquisition of fixed assets*, as well as for meeting temporary bulges in current assets. . . . Commercial loans would never have become an important asset of the American banking system had they been limited to genuine self-liquidating advances.

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> "At the beginning of the present century an obvious schism between theory and practice existed in bank credit relationships with businesss enterprises. Short-term credit forms were used in connection with the advance of funds performing long-term functions in borrowing concerns." N. Jacoby & R. Saulnier, *Business Finance and Banking* 132, 138 (1947) (emphasis supplied).

This blurring of theory in practice has carried over to current times. Commercial paper today plays an important role in the overall financing operations of corporate enterprises. In an era of persistent inflation and high interest rates, capital finance markets, particularly the bond and debenture markets, are subjected to severe strains. In these circumstances:

> "Commercial paper financing by non-financial corporations has become less relied upon for cyclical contingencies and more relied upon as a steady source of short-term funds. . . . [T]he nature of debt as a whole has shifted to the shorter term due to widespread expectations of sustained, high inflation rates. These expectations have made short-term debt more prevalent in corporate financial plans, whereas at one time heavy short-term debt requirements were usually unexpected and temporary." *Commercial Paper—Growth Despite Severe Economic Swing*, Moody's Bond Survey, Nov. 24, 1980, at 238-39.

Would-be issuers of "stocks, bonds, debentures, . . . or other securities" regularly resort to the commercial paper market to satisfy their capital needs. As one current observer puts it: "The recent rapid growth in the commercial paper market owes much to the secular substitution of short-term for long-term debt, which accelerated because of the high rate of inflation in the late 1970s." Abken, *Commercial Paper*, Fed. Res. Bank of Richmond Econ. Rev., Mar.-Apr. 1981, at 11, 16.

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[9] Authorities writing prior to the enactment of Glass-Steagall observed that from the viewpoint of the borrower, notes are ready substitutes for bonds in the capital market when conditions warrant recourse to them. F. Mead, *Corporation Finance* 301 (1919 ed.). Another commentator classified "short-term notes" along with bonds, stocks, and shares as "investment credit instruments." H. Moulton, *The Financial Organization of Society* 107 (1925).

Thus, current market experience affords no basis to treat the instruments enumerated in Glass-Steagall Section 21 as if they differ fundamentally from one another—they are all available as capital-raising mechanisms.[10]

Increasingly, modern corporations have come to look upon commercial paper as a necessary adjunct—and in some cases a primary vehicle—to generate capital. Considerably more than half of the entire short-term debt of finance companies is comprised of commercial paper. Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525, 526 (1977). Moreover, commercial paper has become "an important source of financing for large, well-known firms . . . ." *Id.* at 532.

Goldman Sachs' experience as a commercial paper dealer lends support to the conclusion that issuers frequently look to commercial paper as a substitute for long-term credit, not merely as a funding vehicle to meet temporary or cyclical needs. Many of Goldman Sachs' issuers have sold and continually "rolled over" commercial paper on a daily basis for years, even when such funds might have been raised through conventional long-term borrowing by bond or debenture offerings. The volume of commercial paper placed by Goldman Sachs increases substantially during periods of high long-term interest rates, as was the case throughout much of 1982. From the mid-1970's to the early 1980's, commercial paper outstandings trebled. Hurley, *The Commercial Paper Market Since the Mid-Seventies*, 68 Fed. Res. Bull. 327, 329 (1982). Goldman Sachs' data indicate that for its 10 largest U.S. industrial corporate issuers of commercial paper, the year-end average

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[10] In addition, the availability of revolving lines of credit that establish backing for paper issued over long periods of time, typically several years (*see* Abken, *supra*, at 12), enables corporate issuers to classify their commercial paper as long-term obligations. Financial Accounting Standards Board, *Statement of Financial Accounting Standards No. 6—Classification of Short-Term Obligations Expected to be Refinanced* (1975).

volume of such paper as a percentage of total corporate capital likewise trebled from 1975 to 1980.[11]

Finally, as is evidenced in recent no-action letters issued by the staff of the Securities and Exchange Commission, corporations have issued commercial paper to finance the acquisition or carrying of a broad range of financial assets such as consumer loans, retail installment paper, and equipment leases or equipment installment contracts with maturities of up to five years. *E.g.*, *Liberty National Corp.* (avail. May 6, 1983); *Florida Coast Banks* (avail. Sept. 12, 1983). Commercial paper also has been used to finance the construction or development of fixed assets such as large office buildings, pipelines, utility plant additions, and cable television systems where the paper was to be refunded with conventional financing within periods of up to five years. *E.g.*, *Cox Communications, Inc.* (avail. Mar. 15, 1983); *Tucson Electric Power Co.* (avail. Apr. 22, 1983); *Kuparuk Transportation Capital Corp.* (avail. Apr. 25, 1983); *The Equitable Life Assurance Society of the United States* (avail. Oct. 1, 1983). For a period of time, bank holding companies used the proceeds of commercial paper to finance acquisitions of other financial and non-banking businesses. *See Hartford National Corp.* (avail. Oct. 30, 1981); *First Jersey National Corp.* (avail. June 4, 1981); *Marine Midland Banks, Inc.* (avail. Apr. 30, 1981).[12]

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[11] At December 31, 1982, for Goldman Sachs' 10 largest U.S. corporate issuers of commercial paper, the commercial paper outstandings as a percentage of total capitalization ranged from 5.2 percent to 18.5 percent. Aggregate commercial paper outstandings for these issuers constituted 9.95 percent of their total aggregate capitalization.

[12] It is possible to market short-term corporate notes in such a manner as to enable the issuer to use the proceeds for any purpose whatever, including bricks and mortar and other long-term capital expenditures. This may be accomplished by structuring the marketing effort so as to comply with SEC guidelines for a "private placement." At least several billion dollars of such "restricted" commercial paper are believed to be outstanding, with maturity dates and interest costs not significantly different from conventional "current

In sum, it is erroneous to assume that commercial paper differs so plainly from other financing vehicles that it cannot be deemed a part of a corporation's capital structure. To the contrary, commercial paper—"notes"—is an integral and increasingly significant vehicle for the raising of capital. As such, it should not lightly be read out of Glass-Steagall.

**B. Section 21 as Interpreted by the District Court Below Leaves Commercial Banks Free To Perform Their Traditional Lending Functions**

The court of appeals professed concern that interpreting "notes" in Glass-Steagall Section 21 to include the commercial paper here at issue would lead to unreasonable results, assertedly by removing commercial banks from well-settled banking functions. 693 F.2d at 144 n.48 (J.A. 235). That concern is without basis.

*First*, interpreting "notes" in Glass-Steagall Section 21 to mean all notes, would, as the district court correctly held, leave commercial banks free to "continue to purchase commercial paper"—*i.e.*, to act as lenders—"as they traditionally have." 519 F. Supp. at 613 n.9 (J.A. 213). Purchasing and discounting commercial paper is an exercise of the banks' classical lending funtion. The activity is expressly authorized to federally chartered banks under the banking laws. 12 U.S.C. § 24, Paragraph Seventh.

*Second*, the district court's interpretation of Glass-Steagall Section 21 leaves undisturbed the authority of commercial banks to issue evidences of *bank* indebtedness as a necessary adjunct to their traditional lending activities. Section 21 directs its prohibition to entities engaged in "the business of

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transactions" paper. Although a bank's involvement in the marketing of such "restricted" paper raises somewhat different questions under Section 21, the significance of "restricted paper" is that corporate instruments economically identical to commercial paper may be used to finance long-term capital projects on a permanent basis.

receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, *or other evidence of debt*, or upon request of the depositor" (emphasis supplied). Thus, Section 21 presupposes that commercial banks subject to its proscription of defined *marketing* activities will continue to handle the instruments that finance their traditional *lending* function.

Engaging in lending activities is the *raison d'etre* of commercial banks. They remain free, whenever so authorized by their state or federal charters, to issue evidences of their *own* indebtedness to their depositors in the form of certificates of deposit ("CD's"); to guarantee their *customers'* obligations in the form of bankers' acceptances ("BA's"), thereby lending their own credit in support of their customers' business activities; and to arrange syndicates of fellow banks to participate in loan arrangements. Commercial banks commonly issue both "CD's" and "BA's" to generate funds for their basic lending functions. Such instruments are not thought of as "notes" in the conventional sense. *See, e.g.*, U.C.C. §§ 3-104(2), 3-410(1). Thus, they do not fall within the prohibition of Glass-Steagall Section 21.

The court of appeals thought that commercial banks' sales of instruments such as CD's, notes evidencing mortgage loans, and notes representing commercial loans would be prohibited if the term "note" were given its natural meaning of a "written promise . . . to pay a certain sum to the . . . payee." 693 F.2d at 144 n.48 (J.A. 235), *quoting* G. Munn, *Encyclopedia of Banking and Finance* 698 (7th ed. 1973). That analysis is incorrect. As noted earlier in this Brief, the National Bank Act authorizes federally chartered banks to exercise "all such incidental powers as shall be necessary to carry on the business of banking; *by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt.*" 12 U.S.C. § 24, Paragraph Seventh (emphasis supplied). Comparable provisions exist under state law, such as that of New York, to provide statutory authority to state-chartered banks like Bankers Trust to carry on similar activities. N.Y. Banking Law § 96

(McKinney 1971). Thus, the National Bank Act and parallel state legislation provide ample authority to banks to engage in the traditional lending and discounting function reflected in their conventional discounting of note instruments.[13]

## III. THE HISTORY OF COMMERCIAL BANKS' INVOLVEMENT WITH COMMERCIAL PAPER CONFIRMS THAT BANKERS TRUST'S MARKETING OF THIRD-PARTY PAPER TO UNRELATED PURCHASERS CONSTITUTES A RADICAL DEPARTURE FROM TRADITIONAL BANK ACTIVITY

One sure guide to Glass-Steagall is the practice of commercial banks since the statute's enactment. So far as we can ascertain, not until Bankers Trust's present venture has any commercial bank undertaken such commercial paper marketing activity after Glass-Steagall's passage.

Bankers Trust's activity differs altogether from the handling of commercial paper in which commercial banks traditionally have engaged. From the inception of the commercial paper market in this country through the turn of the century and into the 1930s, commercial banks were present in the market as *lenders*—that is, as purchasers of commercial paper offered initially by mercantile firms seeking short-term financing to assist in their seasonal production, and then, after the

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[13] The court of appeals also thought that "[i]n recent years, the lender [on commercial borrowings generally] has characteristically been either a bank or a syndicate of lenders, which may include banks and lending institutions such as credit or mortgage companies." 693 F.2d at 149 (J.A. 244) (footnote omitted). To the contrary, loan syndicates typically involve a lead *bank* and participating *banks*. *See, e.g.*, Pollock, *Notes Issued in Syndicated Loans*, 32 Bus. Law. 537, 538 (1977) ("it [may become] necessary for *several banks* to join together in a syndicate to provide the required funds") (emphasis supplied). Goldman Sachs is unaware of any practice whereby commercial banks head up loan syndicates including non-bank participants.

First World War, increasingly by financing entities (such as General Motors Acceptance Corporation and other similar consumer lending institutions) that had a constant need for short-term refinancing of loans into the consumer market.

The court of appeals recognized that Bankers Trust's marketing of commercial paper differs from "the traditional lending of commercial banks," but it dismissed the distinction between purchaser and seller of commercial paper as one in which "[t]he bank is simply on the other side of the transaction." 693 F.2d at 150 (J.A. 246). That analysis reflects a fundamental misreading of history and of economic reality. There is a world of difference between commercial banks' historical lending function and Bankers Trust's newly inaugurated middleman activities. The district court had it right when it said: "[B]ased on the undisputed facts, the role of Bankers Trust in its commercial paper transactions is an uncommon one for traditional banking institutions." 519 F. Supp. at 614-15 (J.A. 215-16).

Numerous authorities make the point that up to the Great Depression, commercial banks were by far the largest single group of investors in commercial paper—*i.e.*, they purchased paper at a discount and thereby acted as lenders in the transactions.[14] Before the district court, the Board forthrightly acknowledged the historic role of commercial banks in the commercial paper market. There it said: "Historical studies of the commercial paper market indicate that . . . commercial

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[14] *See, e.g.*, Cleveland Federal Reserve Bank, *Money Market Instruments* 74 (1970); N. Baxter, *The Commercial Paper Market* 39 (1966); New York Federal Reserve Bank, *Essays in Money and Credit* 67 (1964); *Banking and Monetary Studies* 335, 348 (D. Carson ed. 1963); R. Selden, *Trends and Cycles in the Commercial Paper Market* 2, 9 (1963); A. Greef, *The Commercial Paper House in the United States* 63, 96 (1938); 3 B. Beckhart, *The New York Money Market* 234 (1932); R. Foulke, *The Commercial Paper Market*, ch. III (1931); Steiner, *The Commercial Paper Business*, 7 Fed. Res. Bull. 920, 924 (1921).

paper was the functional equivalent of a bank loan. . . . [It] was sold almost exclusively to commercial banks" (Memorandum in Support of Motion to Dismiss or for Summary Judgment, filed January 19, 1981, at 18-19) (emphasis supplied). The Board confirmed the point in its opening brief in the court of appeals: "[H]istorically commercial paper was purchased *almost exclusively by banks for their own accounts*, and thus represented a commercial loan from a bank" (Brief for Appellant at 10) (emphasis supplied).

Of the commercial banks that invested in commercial paper, by far the preponderant banks in number and amount were the so-called "country banks"—banks that were located outside the Reserve Cities, and that looked beyond their immediate localities for opportunities to invest their customers' deposits. Such banks regularly dealt with commercial paper houses, which maintained solicitation forces in the field to market the commercial paper brought to the houses by the mercantile interests seeking to raise capital. Baxter, *supra*, at 39; Beckhart, *supra*, at 234; Steiner, *supra*, at 923.[15]

On occasion, it appears that commercial banks, including the big city banks, took commercial paper either directly from the issuers or indirectly through commercial paper houses, and placed portions of the paper, or "participations," with other

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[15] As Goldman Sachs advised the courts below, the big city banks played a largely passive and peripheral role in the handling of commercial paper. In the experience of Goldman Sachs, the big city banks did not invest heavily in commercial paper. Rather, their activities were confined to the execution of commercial paper transactions on behalf of their correspondent country banks and pre-existing customers. Such services were rendered as an accommodation. Any fees charged were service fees. The city banks took little commercial paper for their own account. It followed that they resold little, if any, such paper. Thus, at no time were they in the position of marketers looking to the "spread" between the purchase and sale price on the paper as a source of profit for themselves. *See* Baxter, *supra*, at 39; Steiner, *supra*, at 923.

institutions. These participations were with *other banks. See* Greef, *supra*, at 379. Thus, the participations closely resembled the traditional bank process of syndicating corporate loans among correspondent banks. This process of syndication, by which a lead bank introduced correspondent banks to share in a corporate loan transaction, again was entirely consistent with the banks' recognized and traditional *lending* function. *See* Pollock, *Notes Issued in Syndicated Loans—A New Test to Define Securities*, 32 Bus. Law. 537, 538-39 (1977); Baxter, *supra*, at 57; Greef, *supra*, at 63.

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In sum, the contemporaneous commercial experience surrounding the enactment of Glass-Steagall amply corroborates the point graphically made by the statute itself. Commercial banks in the period antedating the Great Depression and continuing through that period handled commercial paper as lenders, not as marketers. Until Bankers Trust's recent foray, commercial banks left to the investment banking houses the business of taking up issues of third-party commercial paper and placing them with prospective investors.

## CONCLUSION

For the reasons set forth in this Brief, Goldman Sachs as *amicus curiae* respectfully urges the Court to reverse the judgment of the court of appeals below, with instructions to that court to conduct such other and further proceedings (including remand to the district court) as may be necessary or appropriate.

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